

Central Intelligence Agency



Washington, D. C. 20505

State Dept. review completed

DIRECTOR OF INTELLIGENCE

28 June 1985

The Upcoming Soviet-Chinese Trade Agreement:
A Political and Economic Step ForwardSummary

Chinese Vice Premier Yao Yilin will sign a Long Term Trade and Economic Cooperation Agreement (1986-1990) during his visit to Moscow in early July--the first such agreement in over twenty years. No official target on trade turnover reportedly will be established as part of the agreement, although [redacted] total trade for the period could reach \$16-20 billion--compared with an expected \$4 billion during 1981-85. Even with such a large increase, bilateral trade by 1990 would represent less than 10 percent of each country's total trade. By comparison, in the late 1950s the Soviet Union made up about 50 percent of China's total trade. [redacted]

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To reach a trade turnover between \$16-20 billion, the Chinese will have to substantially increase their supply of farm products, textiles and other consumer related items to the USSR. In return, the Soviets can be expected to furnish China with additional amounts of manufactured goods, chemicals, raw materials and transport equipment. In addition, Moscow probably will provide capital equipment, machinery and technical assistance for a number of new development projects scheduled during China's Seventh Five Year Plan (1986-1990)--the first such project assistance since the 1950s. [redacted]

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This memorandum was prepared by [redacted] Economic Performance Division, SOVA, with major contributions from [redacted] Third World Activities, SOVA and [redacted] China Division, OEA. Comments and queries are welcome and may be directed to Chief, Economic Performance Division [redacted]

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Although a last minute hitch could delay the signing of the new agreement, both sides have strong political and economic incentives for expanding trade ties. Politically, the agreement builds on the success of Soviet First Deputy Premier Arkhipov's visit to China in late December and represents yet another step the two sides have taken to improve bilateral relations. Although Moscow and Beijing remain at loggerheads over basic security and political issues, they apparently see improved economic relations as one way to partially balance their ties with the US. At the same time, they probably hope that over the longer term, increased trade and economic cooperation will help pave the way for progress on other issues between them. [REDACTED]

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Economically, the new agreement should also prove beneficial to both. Despite the low level of trade in recent years, the two countries are natural trading partners in the sense that each has goods to export needed by the other. On the Soviet side, for example, increased agricultural and textile imports could give some impetus to its troubled Consumer Goods Program that is scheduled to be unveiled as part of the upcoming 12th FYP, as well as to help conserve hard currency. At the same time, increased trade will also provide the Soviets with an outlet for their machinery and capital equipment for which there is little demand in the West. The Chinese, for their part, will gain an additional market for their fast growing supply of textiles and other consumer related goods, exports of which are becoming increasingly hard to sell in the West (including the US) because of import restrictions. Soviet capital equipment and machinery should help improve China's industrial performance without the expenditure of hard-currency. [REDACTED]

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Given the strong economic incentives for increasing trade, we believe trade turnover could, indeed, reach \$16-20 billion for the period 1986-90. To reach this goal, however, the two countries will have to overcome transportation problems that are, even now, limiting shipment of goods. At the same time, a sudden deterioration in bilateral political ties would also almost certainly be reflected in a trade slowdown. [REDACTED]

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The New Trade Agreement: Where It Stands Now

After nearly two years of discussions, final details on a long term trade and economic cooperation agreement for the 1986-90 period were apparently worked out in early June when Soviet Vice Minister Grishin traveled to Beijing and reportedly initialed the accord. [] the formal signing will take place sometime during Vice Premier Yao Yilin's trip to Moscow, now scheduled for 9-16 July. []

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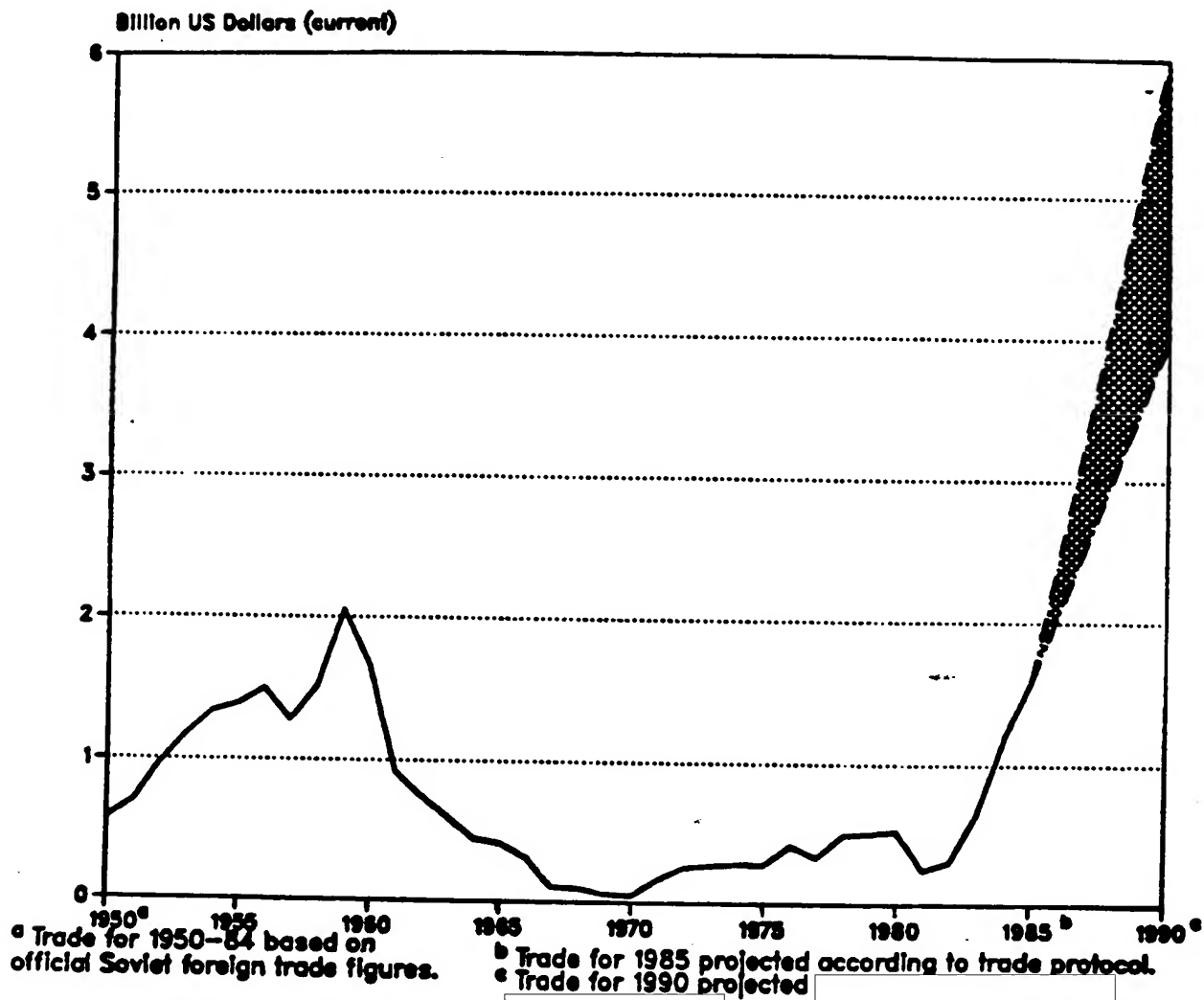
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No official statements on the agreement's contents have been released publicly so far. In fact, a Chinese expert on the Soviet Union in the Ministry of Foreign Affairs stated recently that even when the agreement is signed, no figure on trade turnover will be announced publicly. In separate discussions with US embassy personnel this spring, Soviet and Chinese sources indicated that bilateral trade--excluding border trade--probably would reach \$4-6 billion by 1990 and total somewhere between \$16-20 billion for the 1986-90 period. More recently, however, Yugoslav diplomats in Beijing indicated that total trade might only reach \$13 billion. Regardless of the precise figure, it will represent a several-fold increase over the 1981-85 period; based on trade figures for the first four years of this period, total Sino-Soviet trade for 1981-1985 will probably reach just over \$4 billion, with trade in 1985 projected at around \$1.6 billion. (See figure 1) []

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Figure 1

Sino-Soviet Trade, 1950-90



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[REDACTED]

Boxed Inset

Sino-Soviet Border Trade

A dynamic element in China's trade with the Soviet Union which will not be covered in the upcoming agreement between the two countries is cross border trade. Such trade is arranged among local Chinese and Soviet authorities to take advantage of regional needs. This trade--which resumed in 1982 after a break of more than 15 years--could reach \$80 million this year. Border trade presently consists primarily of Soviet fertilizer, construction materials, timber and transportation equipment in exchange for Chinese farm products and textiles. Trade officials in Heilongjiang Province have indicated, however, that late this year they will begin negotiating for the Soviets to renovate some of their factories. [REDACTED]

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End Box Inset

[redacted] the long-term agreement will set out a general framework within which the yearly trade protocols can be negotiated. To handle the increased level of trade, the agreement reportedly will establish two types of barter exchange. The first--as is the case now--will require the yearly settlement of accounts. The second type, however, will allow the Chinese to pay for their imports of capital goods and technical assistance over a multi-year period. [redacted]

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The agreement reportedly will also involve the Soviet supply of machinery, capital equipment and technical assistance to support China's Seventh Five-Year Plan (1986-1990). [redacted]

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[redacted] the agreement will include Soviet participation in 5 new Chinese development projects--two thermal power plants, two coal mines and a 1000KM rail line--as well as the renovation of 13 existing plants. If true, this would mark the first time in over twenty years the Chinese have asked the Soviets for assistance and technology in the construction of new plants. In addition to these larger projects, there are a number of smaller ones--such as helping renovate some of Beijing's infrastructure--which have also been targeted for Soviet participation.¹ [redacted]

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Soviet deliveries of manufactured goods, chemicals, raw materials, and transport equipment are also likely to rise as result of the new agreement. Beijing will continue to need

¹ By way of comparison, during the height of the Sino-Soviet relationship Moscow was involved with over 200 projects in China. [redacted]

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imports of such Soviet metals as nickel and steel alloys. At the same time, despite recurring problems with quality and tardy delivery, China will probably want to increase its imports of timber, industrial chemicals, and fertilizers. [REDACTED]

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China will likely balance these imports with the shipment of farm products and consumer goods (see figure 2). We expect Moscow will seek to increase its imports of meat, soybeans, grain--mostly corn--and other agricultural products. Similarly, to supplement its own production, Soviet imports of wool, cotton, apparel, and textiles--both fabric and fibres--are likely to rise. Finally--if the Chinese can boost their domestic production--the Soviets also may try to boost their imports of consumer electronics such as TVs and radios. [REDACTED]

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The Politics of Trade

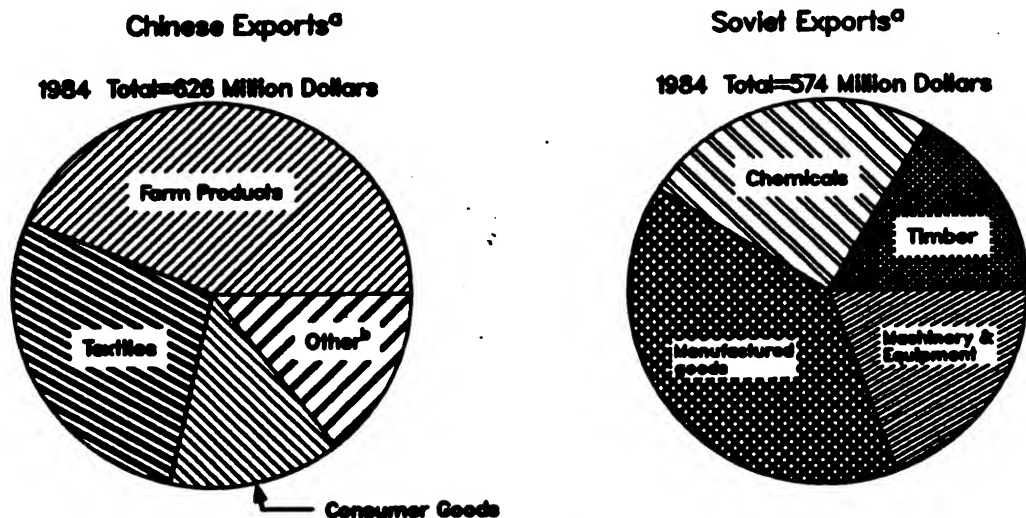
While both sides will benefit from an expanded economic exchange, the decision to capture this expansion within the framework of a publized offical trade agreement, after a 20 year hiatus, reflects a number of political factors. [REDACTED]

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Recognizing that their total estrangement did them little good--and actually helped Washington in its dealings with both of them--the USSR and China began a fresh effort to moderate the level of hostility between them about four years ago. With the Soviets taking the lead initially, Beijing and Moscow began a slow process of improving relations in 1981 that included:

Figure 2

Sino-Soviet Trade Composition 1984



^a Composition of trade data is based on official Chinese trade figures. The 1984 total is derived from official Soviet trade figures.

^b Other is composed mostly of iron ore, chemicals and fertilizer.

- o Regular political consultations at the Deputy Foreign Minister level.
- o Low-level nonpolitical contacts at athletic meets, cultural events, and the like.
- o A sharp increase in bilateral trade and a resumption of scientific, and technical exchanges. [REDACTED]

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Probably the most important of these moves was the resumption of Sino-Soviet political discussions in October 1982. Although the six rounds of "consultations" to date have done little to resolve major political and security issues, they have, nonetheless, helped lower tensions. Moreover, by expanding various forms of cooperation, as well as increasing bilateral trade, Moscow and Beijing have helped repair some of the damage inflicted on their relationship during the 1960s and 1970s. Their success in improving relations, in turn, has served to remind the United States and other interested third parties that Sino-Soviet ties are not frozen, even though the two sides remain deadlocked on the main political and security issues dividing them. The signing of the new agreement calling for a major upturn in trade and Soviet participation in Chinese development projects would reinforce this perception. [REDACTED]

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Besides helping both sides to show some balance in their ties with the US, both countries have individual reasons for signing a new trade accord. The Soviets almost certainly look upon the new agreement with China--especially with its focus on

project assistance--as a means of regaining some of the influence that they had wielded in Beijing before relations deteriorated in the early 1960s. Indeed, [] a number of the USSR's top Sinologists believe that there are Chinese officials who are dissatisfied with the current leadership's policy of developing close ties with the West, particularly with the United States. According to these Soviet experts, many of the [] Chinese cadre were educated in the USSR during the 1950s, and want a return to "the good days" or at least a more balanced approach to the two superpowers. []

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Although the Soviets almost certainly have tailored such remarks for the benefit of Western interlocutors, we believe, in fact, that there are some senior Chinese who are more receptive to Soviet proposals to expand relations than others in the leadership. While the degree of support is probably not as widespread as the Soviets claim, some Chinese apparently do see increased trade and economic exchanges--which are unlikely to evolve into economic dependencies--as a comparatively safe way to improve their relationship with the USSR without compromising on more fundamental political issues.² Other Chinese leaders also may find it politically expedient at present to show their

² According to the Chinese, there are three major "obstacles" to better relations. They involve Soviet troops along the Sino-Soviet borders, Soviet involvement in Southeast Asia, and the continued occupation of Afghanistan. []

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domestic opponents that they are ready for some progress with the Soviets, at least in the economic area. [REDACTED]

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Economic Benefits From Increased Trade: The Soviet Perspective

In addition to these political reasons, both the Soviet Union and China have strong economic incentives to sign the new agreement. The Soviet Far East, due to its northern location, does not produce sufficient amounts of agricultural products to support itself. Because of the high transportation costs involved in moving such items--in addition to most other goods--to its Far East region, Moscow is undoubtedly anxious to beef up imports of agricultural products and consumer goods from China.

[REDACTED]

Besides reducing shortages in the Far East, increased imports of textiles and other consumer related goods also would provide a boost to the Soviet Long Term Consumer Goods program that is scheduled to be unveiled as part of the upcoming 12th Five Year Plan. [REDACTED] the completion of plans for the program have been delayed because of the lack of investment resources internally, as well as problems in negotiating future deliveries of appropriate consumer goods from Eastern Europe. [REDACTED]

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Another positive aspect of increased trade from Moscow's vantage is that it will allow the USSR to import some goods that would otherwise require the expenditure of foreign exchange. Although any hard currency savings from increased Chinese imports

will be relatively small in comparison with total hard currency expenditures, they are important at the margin. China can probably supply Moscow with 1-3 million tons of grain--primarily corn--and several hundred thousand tons of soybeans annually for at least the next few years. To the extent that these purchases replace those from Western suppliers, Moscow could save anywhere from \$200-500 million a year. Similarly, Moscow would undoubtedly like to reduce its hard currency expenditures for meat--which averaged \$350 million in 1981-1984--by additional purchases from China. In 1984, imports of meat from China totaled over \$100 million. [REDACTED]

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The Soviet cost in boosting consumer goods and agricultural imports is not that great. There is minimal free world demand for the Soviet equipment which will be exported to China in return. [REDACTED]

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The Chinese Side of the Ledger

While increased imports of textiles and other consumer related goods would help Moscow to deal with its supply problems, they would also provide China with an outlet for its growing textile fibres and textile product production. Both the U.S. and Europe have placed restrictions on the import of some Chinese products--including textiles and consumer related goods--forcing Beijing to search for alternative markets. [REDACTED]

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The use of Soviet capital equipment, machinery, and Soviet assistance--in addition to raw materials--will also prove

beneficial to Beijing. The Chinese have apparently decided that for some of those factories built originally with Soviet help, it is cheaper to modernize using Soviet equipment. Although this equipment may not be as technologically advanced as that available from the West, it will still improve industrial performance. The Chinese probably also believe that for a number of new projects--primarily energy--the Soviets can provide technology that is as good as in the West and without the expenditure of hard currency. [REDACTED]

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Prospects

Given these incentives, we believe trade turnover of \$5-6 billion by 1990 is possible. Indeed, the present level of Sino-Soviet trade is such a small fraction of each side's total trade--1 to 2 percent--that even if it reaches the \$6 billion level by 1990--it still will probably represent less than 10 percent of each country's total trade. Even this level could prove elusive, however, if bilateral political ties deteriorate. [REDACTED]

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Beyond 1990, we would also expect trade to continue to increase, although probably at not as rapid a rate. Whether modernizing existing plants or planning new ones, Beijing may see merit in drawing upon increased imports of Soviet machinery, capital equipment and technical assistance. For its part, Moscow will probably continue to want increased quantities of farm products and textiles to supply the Far East and increase consumer welfare. [REDACTED]

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Transportation problems, however, may prove a long-term impediment to trade. Even now, rail transport is so tight on both sides that many products are shipped by sea, where port congestion in both China and the Soviet Union has slowed movement. China is building new port capacity to alleviate sea-going freight delays, but planned improvements to the rail system are not likely to be sufficient to eliminate major problems.

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